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THE NATURE AND PROBLEMS OF SOVIET ECONOMIC PENETRATION
OF UNDERDEVELOPED AREAS

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S-E-C-R-E-T

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I. Introduction.

The Soviet Bloc is engaged in a determined and accelerating drive to establish closer economic, political, and cultural relations with Free World countries politically susceptible to such influences. Although still in its early stages, the Bloc offensive is a well-planned and integrated one -- vigorous, selective, and opportunistic. Soviet economic expansion has proceeded by a succession of related actions affecting particularly the underdeveloped countries of the Middle East and South and Southeast Asia. The recent extension of the program to Latin America and Africa reflects its global scope.

Soviet leaders are offering a steady flow of capital equipment and technical assistance to industrialize the underdeveloped countries and also offering a stable market for their primary commodity exports. Of particular appeal is Soviet willingness to accept payment in exportable surpluses or local currencies and the extension of long-term low-interest capital credits. As of 1 February 1956, the Bloc has offered credits, primarily for capital goods, totaling about \$1 billion. Acceptances so far approximate \$600 million to be used over a period of up to 5 years. The Bloc is supplying additional assistance by direct purchases of basic commodities; for example, it has contracted for one-fourth of Burma's estimated rice exports in 1955.

The Bloc has the economic capability not only to meet these commitments but also to provide for a substantially expanding program of capital equipment and armaments exports. The basic agricultural and mineral products obtained in exchange for capital exports represent in many cases much-needed raw materials and foodstuffs -- so that the trade relationship involved is of net advantage to the Soviet economy, over and above political considerations.

Soviet spokesmen are proclaiming this economic competition with capitalism as an opportunity to establish the "historic superiority of socialism." Although the Bloc program to date is small, it poses an increasing challenge to US foreign policy and to the traditional trade and political interests of other nations of the Free World that it would be dangerous to underestimate.

S-E-C-R-E-T

S-E-C-R-E-T

II. Purposes and Objectives.

The coordinated economic and psychological offensive represented by the new program seeks to neutralize US influence and undermine the Western politico-military position in areas adjacent to the Soviet Bloc. The initial emphasis has been on those uncommitted countries where it would have the most immediate and useful political effect: Yugoslavia, Egypt, India, Burma, and Afghanistan. Recent approaches have included countries presently aligned with the US, such as Pakistan and Turkey.

The Soviets are identifying themselves with the satisfying of the great concern of the governments and peoples of the underdeveloped countries for political and economic progress. They are dramatically publicizing the inherent advantages of the Communist system for achieving rapid industrial and technological development without disclosing its forced labor aspects. The argument put forward is that the USSR has become in one generation an industrial power of the first rank and that the Communist states are able and willing to assist other countries to achieve similarly rapid industrialization.

The Bloc also seeks to demonstrate the superior effectiveness of Communism by the flexibility of its program in meeting the needs of the underdeveloped countries for liberal capital credits and for stable outlets for their raw material surpluses, with a lack of apparent political strings. In contrast, the Western "colonial" powers are represented as seeking to subvert underdeveloped countries by entangling alignments; penetrating their economies through private investments, and keeping them as undeveloped producers of primary materials. At the same time, Soviet leaders are encouraging these countries to use Soviet offers and credits as increased bargaining power and leverage in negotiations with the West. Thus even additional aid from the West is claimed "as indirect help by the Soviet Union."

Furthermore, the USSR and Eastern Europe find it advantageous on economic grounds to export a relatively varied line of capital goods in return for certain food and raw material imports. Additional output from many extractive and agricultural sectors has become more costly than producing additional industrial goods to exchange for these primary

- 2 -

S-E-C-R-E-T

S-E-C-R-E-T

materials. The shift in the trade pattern of the USSR from importing capital goods and exporting raw materials to exporting capital goods and importing raw materials, a shift previously experienced by other maturing industrial economies, is being achieved at a time highly advantageous to the Soviet Bloc. The political and strategic opportunities are great when politically vulnerable, capital-hungry nations need the kinds of capital goods which the Bloc has the capability to export and when the USSR can readily absorb their exportable surpluses.

A related long-term objective of the Bloc is to disrupt trade relations between the underdeveloped countries and the industrialized capitalist states, including the United Kingdom, West Germany, and Japan. By encroaching on the traditional foreign trade markets of the capitalist trading countries, it may be possible simultaneously to increase capitalist competition for remaining markets and to gain Bloc control of raw material supplies, such as Middle East petroleum, on which the Western countries are dependent. It has for some time been an announced Soviet aim to create a "democratic" world market which would rival and ultimately supersede the capitalist world market.

III. Characteristics of the Program.

The main economic attack of the Soviet Bloc combines offers of capital equipment with technical assistance. These offers are related to industrialization projects in the underdeveloped countries, the exploitation of their latent raw material resources, and the expansion of their transport and communications system. Many of the projects appear to fall in the category of the massive "symbols" of progress most appealing to the local governments and most obviously apparent to their people.

Sales of capital goods are accompanied by a wide range of technical assistance in support of indigenous programs for economic development and for improved public administration. This assistance includes not only the sending of Soviet technicians into underdeveloped countries but also the training of native students, teachers, technicians, and leaders in Soviet institutions.

Conventional armaments are supplied as a specialized type of trade goods. The supply of industrial consumer goods has not been neglected, and trade in these is beginning to develop. The Soviets are also offering assistance in nuclear fields -- an area of hitherto unquestioned US international leadership.

- 3 -

S-E-C-R-E-T

S-E-C-R-E-T

The Soviet emphasis for financing their assistance has been almost exclusively on loans with "soft" terms (long-term repayment at 2 to 2½ percent, or hardly half the World Bank rate) and on bilateral trade agreements particularly advantageous to exporting countries. These trade agreements are directed toward Soviet purchases of exportable surpluses which Western countries are reluctant to buy. In some cases the Soviets are willing to accept in payment large quantities of local currencies.

The Bloc has particularly sought to appeal to underdeveloped countries by offering a stable market on favorable terms for their commodity surpluses. In the process the Bloc may emerge as a major "broker" for certain primary commodities. Thus rice purchased from Burma has been resold to Ceylon and French West Africa. Although the Bloc is approximately self-sufficient in cotton, it has moved into the Free World cotton market on a large scale by importing from Egypt and other producing countries while doubling USSR exports to West European countries.

Paralleling the economic drive of the Bloc, there is an equally determined propaganda drive, including personal visits of political notabilities, prestige exhibits at fairs and exhibitions, the establishment of local trade offices, and advertising in local newspapers -- to create a climate of opinion favorable to Bloc international economic and political programs.

IV. Economic Capabilities.

The USSR has become the second industrial power in the world. It has enforced a continuing high rate of industrial investments, although sustained only at considerable hardship and by enforced low living standards for its people. More recently the European Satellites have similarly concentrated on industrial construction. The present capital equipment contracts and offers to underdeveloped countries are for the construction of factories similar to those which the USSR and its more industrialized Satellites have been erecting for some time in their own territories. Communist China, also, is participating in the coordinated trade drive, although the scope of its effort is necessarily limited.

The credit program so far offered to underdeveloped countries will impose no net economic burden on the economies of the Soviet Bloc. The amount of credit involved, about \$1 billion (spread over a 5-year period), amounts to only 1 percent of annual industrial production. Substantial

- 4 -

S-E-C-R-E-T

S-E-C-R-E-T

further commitments could be accepted without imposing any great strain on the economic capacity of the Bloc and without changing the main direction of its output. As its own requirements for conventional armaments are satisfied, or international tensions further relaxed, a reduction of armaments production would release important industrial capacity for additional exports of capital goods and industrial equipment. Under these circumstances the USSR could export capital goods on a scale comparable with the United Kingdom or West Germany.

Because obtaining additional output in the agricultural and extractive sectors of the Bloc economy is becoming more costly, the exchange of capital goods for surplus commodities supplements net Bloc resources in an increasingly important degree. Hence the general impact of the program upon the Bloc should be to foster economic growth and to enable the Bloc to utilize its resources more effectively. During the next 5 years, industrial production of the USSR probably will grow by more than 10 percent per year, faster than that of any other industrial country. The expanding capability to export capital goods and the increased requirements for raw materials mean that the scale of the Bloc's economic drive in underdeveloped countries could be steadily enlarged.

The Bloc can easily supply conventional armaments from current production, from large stocks, or from recently obsolescent holdings. Such exports of armaments provide particularly effective penetration into areas where local tensions are already high, such as the Middle East and South Asia.

The Soviets are in an excellent position to compete with the US in providing trained technicians for technical assistance. In 1954 the USSR graduated some 53,000 engineering specialists, compared with about 20,000 for the US. Although higher education in the USSR is generally narrower than in the US, Soviet technical training is equal to ours. Furthermore, Soviet graduate engineers go where they are sent, whereas arrangements for leave of US experts from their usual employment are often difficult.

- 5 -

S-E-C-R-E-T

S-E-C-R-E-T

V. Inherent Soviet Advantages and Disadvantages.

The disappointing effect of substantial US programs of assistance over the past 5 years in winning over the countries of the Middle East and South and Southeast Asia contrasts with the increasing impact apparently being made by the presently more modest program of the Soviet Bloc. This situation is attributable, at least in part, to certain inherent Bloc advantages over the US in dealing with these areas.

The economies of the underdeveloped countries are much more complementary with the Bloc than with the US. The lag in Bloc agricultural production makes possible the import of surplus agricultural commodities for which these countries must find a market, whereas the US is itself beset with surpluses of many of the same products and exports cereals, cotton, and other staples in direct competition. This greatly enhances the Bloc's bargaining position in selling industrial products to these areas. Although capital goods exports from the Bloc are frequently not up to Western technical standards, their very simplicity makes them more desirable for users in underdeveloped areas.

The Soviets take full advantage of their centralized and monopolistic control of the economies of the Bloc to mobilize the available Bloc resources for calculated purposes. In competition with Free World industry, the Bloc can more easily arrange for complete equipping of complex industries, for acceptance of surpluses in barter exchanges, and for absorbing the cost of any subsidies required for trade or credit concessions. The countries of the Bloc are also able to enforce sacrifices in their domestic economies in order to meet foreign objectives. Not only have Soviet negotiations been very flexible in credit and trading arrangements, but in addition, they have astutely not sought any obvious quid pro quo in terms of political alignments, MDAP-type agreements, or Battle Act commitments.

The issue of "colonialism" is easily raised against us in these areas. The US is identified with the former colonial powers of the West, through SEATO and through a concerting of action in the Near East -- alliances which are resented by countries not included, even though their noninclusion is a matter of their own choice. The opposition of the Soviets to the "alliances of the colonial powers," together with the racial and geographic background of the Soviets, have made it possible for them to pass as non-Europeans, as fellow Asiatics.

- 6 -

S-E-C-R-E-T

S-E-C-R-E-T

The peoples of these areas believe that the West, particularly Europe, has obstructed their industrialization in the past and will continue to discourage it in the future, so as to keep them as sources of primary commodities and as markets for consumer-goods exports. Consequently, they are easily susceptible to Communist claims that US aid programs are a form of economic imperialism or colonialism.

Many of these underdeveloped countries, underestimating the difficulties involved in industrialization, have thought that when colonial status ceased, their economic advance would progress rapidly. It did not; and we have tended to point out that economic progress is a slow process which required a sound foundation of supporting financial and political stability. The Soviets, on the other hand, through subtle and persistent propaganda, have impressed many people in these countries with the alleged success of the Communist system in transforming the USSR in a short span of years from a backward agricultural country to the first rank of military and industrial powers. This Communist appeal plays on the desires of the underdeveloped countries for rapid economic advancement and makes them more susceptible to cooperating with the Bloc so that they too can, somehow, achieve a measure of growth similar to that which they see in the USSR.

In some countries there are particular causes for suspicion of the US which the Soviets seek to exacerbate. Our attempts to preserve a balance between Israel and the Arab states have permitted the Soviets to intervene as supporters of the Moslem world. US support of Pakistan alienates India and Afghanistan. Furthermore, these countries see US economic aid tapering off, while the bulk of it is going to individuals and regimes which they do not like -- for example, Rhee, Chiang, Japan, and Israel.

The Soviets use their foreign economic programs to encourage neutralism. Many of these countries have in general already adopted a "no entangling alliances" role in the world conflict, to which American public discussions often refer in terms offensive to them. They believe they can best continue to maintain their independence if they accept both US and USSR aid, and they are not averse to playing off one against the other.

- 7 -

S-E-C-R-E-T

S-E-C-R-E-T

The political and economic instability of the underdeveloped nations and an obsession with their own problems bring growing opportunities for Soviet political and economic penetration and a tendency to ignore the political implications of the Soviet proposals.

Offsetting the clear Soviet advantages are certain counterbalancing factors, some external and some internal. Native leaders tend to overlook the fact that US economic development has been more rapid and better balanced than that of the USSR and that in addition to maintaining a rapid economic growth and a large military capability the US has never stopped raising the living standards of its people. They have yet to appreciate fully the extent to which Soviet military and industrial advances have been achieved through the ruthless subordination of individual freedoms and of the living standards of the people.

The capitalist states of the West have better developed industrial systems for generating capital exports, which in a more liberalized market framework could maintain a clear competitive advantage over the Bloc.

The Communist program, although astutely initiated and selectively concentrated, is still in an early offer and promise stage. There may be frustrations and failures in dealing with the Soviets, discrepancies between Soviet promises and performance. Yet it would be unwise to rely unduly on this factor, since the new Soviet leadership has shown an unusual degree of adaptability and since the Soviets have gained valuable experience in China in dealing with sensitive Asiatics.

Internally, the Bloc is not without certain political and economic tensions and strains arising from an arbitrarily imposed centralized authority, a low domestic standard of living, captive Satellite nations, and obligations to China. None of these factors, however, appear to be of sufficient importance in the eyes of the Soviet leaders to act as a deterrent to the expansion of their foreign economic programs.

- 8 -

S-E-C-R-E-T

S-E-C-R-E-T

VI. International Impact.

The developing threat of Communist trading with underdeveloped areas is not yet fully apparent in the trade data. It is clear, however, that Soviet Bloc trade with these areas is increasing. For example, Bloc trade with Latin America has in the past 3 years increased from 1 to 7 percent.

There are no large pools of private savings for capital investment in underdeveloped areas. For this purpose, these areas must obtain foreign credits or force internal savings by depressing an already low standard of living. The Bloc has an expanding capability to extend capital credits to these capital-hungry areas and is beginning to do so where related political objectives are clearly served.

To the extent that Bloc capital credits and trade with these areas expand, it will disturb established patterns of Free World trade and will tend to limit the trading opportunities of the major Free World Allies of the US, particularly Western Europe and Japan.

Since credits for the installation of capital goods and for capital assistance generally involve long-term arrangements and since trade patterns once established tend to continue, the Bloc may be in a position to pre-empt certain segments of world trade for an indefinite period. Similarly Bloc imports of primary commodity surpluses are being made on a bilateral barter basis rather than for internationally convertible currencies, thereby tending to tie directly the economies of the countries involved to Bloc trading arrangements.

The stability and development of the industrial economies of Western Europe and Japan are heavily dependent on foreign trade. Largely because of past political disruptions of foreign trade and investment markets, these Free World countries are presently experiencing difficulties in maintaining adequate markets for their industrial exports. Their industrial capacities would support a greatly expanded export of industrial goods, thereby increasing their requirements for raw materials and agricultural imports. The increasing entry of the Bloc into the markets of the underdeveloped areas will tend to further restrict Free World trading opportunities.

- 9 -

S-E-C-R-E-T

S-E-C-R-E-T

By extending its economic drive, the Bloc will not only gain increasing political influence in the underdeveloped areas but also will be indirectly increasing the economic and political pressure on our Allies. Limitation of West German foreign trade markets, for example, could be used as a pressure for obtaining long-term capital exports from West Germany to Communist China on Soviet terms. Serious interference with the foreign trade markets of the United Kingdom would bring increasing internal political pressures for reduction of UK defense expenditures and a neutral accommodation in the world conflict. These effects would of course be greatly intensified if a recession in the US occurred in conjunction with a significant decline in world prices for primary commodities.

VII. US Problems Posed.

The US itself is not economically threatened by the economic drive of the Soviet Bloc, since our dependence on foreign trade is relatively limited. The main threat to the US is political and strategic. The capabilities and advantages inherent in the Bloc programs of economic penetration, indicated above, provide the basis for an effective campaign to limit US leadership and influence in the underdeveloped countries and to weaken the Western alliances.

The most striking disadvantages of the Soviet system -- its destruction of freedoms and limitation of living standards -- are viewed with relative indifference by populations which have never known anything else. The specter of possible Communist oppression is less motivating to them than the remembrance of recent colonial controls. And Bloc living conditions which are low by Western standards are nevertheless already far above those of mass populations in Asia and Africa.

Soviet bargaining strength and flexibility in this campaign are enhanced by the centralized decision-taking authority of state trading operations, which afford a degree of governmental maneuverability that is difficult to attain under normal democratic processes. Such maneuverability is, at least in the short run, a definite advantage which adds significantly in timing and effectiveness to the value of Soviet actions. Soviet capabilities are multiplied by an unquestioned authority to allocate goods from the gross national product of the Bloc for opportunistic trade -- for economic and political infiltration.

- 10 -

S-E-C-R-E-T

S-E-C-R-E-T

There is no need to justify the direction, amount, or terms of these foreign programs to a domestic electorate. Ministers are not subject to questioning by a Parliament or Congress, or by a free press. Consistency of policy with respect to individual transactions or nations does not become a public issue. Changing conditions can be met with a complete flexibility of decision. Transactions with other nations can be varied to accomplish a calculated advantage to the Soviets and to embarrass the rest of the Free World.

In contrast to the flexibility of Soviet state trading practices, implementation of US foreign assistance programs is burdened by the excessive lead-time required to authorize, appropriate, and expend foreign-aid funds. More than a year of executive planning and congressional hearings is ordinarily required before funds can be appropriated and specific US aid commitments discussed with other countries. Negotiations with the recipient governments, followed by technical discussions and actual implementation of projects, may require upwards of another 24 months before funds are finally expended. Such long lead-times make it difficult to maintain continuity in US aid policies and also preserve the flexibility necessary for adapting current program operations to changing international situations.

25X1



- 11 -

S-E-C-R-E-T

S-E-C-R-E-T

SINO-SOVIET BLOC CREDITS TO NON-BLOC COUNTRIES
EXTENDED OR UNDER SERIOUS CONSIDERATION a/

Million US \$			
<u>Recipient Areas</u>	<u>Actually Extended</u>	<u>Under Serious Discussion</u>	<u>Total</u>
Middle East			
Egypt	147	200	347
Iran	3		3
Lebanon		3	3
Saudi Arabia		5	5
Sudan		3	3
Syria	8	91	99
Turkey	3	6	9
South Asia			
Afghanistan	112	10	122
India	105	30	135
Indonesia	18	6	24
Europe			
Finland	20		20
Yugoslavia	<u>204</u>	<u>—</u>	<u>204</u>
Total	<u>620</u>	<u>354</u>	<u>974</u>

a. Information as of 1 February 1956.

- 12 -

S-E-C-R-E-T

S-E-C-R-E-T

S-E-C-R-E-T